BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 93-215
	)	
Rate Regulation	)	

REPLY COMMENTS OF MEDIA GENERAL CABLE OF FAIRFAX COUNTY, INC.

Media General Cable of Fairfax County, Inc. ("Media General") submits these comments in reply to certain of the submissions made by other parties to this proceeding.[1/]

I. Cost-of-Service Rate Justifications Must be Freely Available to All Cable Systems

The benchmark rate system created through the Rate Order[2/] is based on mathematical averages and, as such, is subject to the infirmities that mechanical averaging necessarily produces. One of the more obvious infirmities in averaging is

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1/ We do not revisit each of the issues addressed in Media General's original comments. We were pleased to see that a broad range of commenters endorsed the common sense notion -- expressed in our initial comments -- that prior year losses must be recoverable in cost-of-service based rates. See, e.g., Comments of Continental Cablevision, Inc., 17-21, 28-32; Comments of Michigan Ad Hoc Committee for Fair Cable Rates, 15-16.

2/ Rate Order and Further Notice Proposed Rulemaking, MM Docket No. 92-266, 58 Fed. Reg. 29736 (1993).

that it will produce benchmark rates which will be too high -- that is, they will yield a supra-competitive profit[3/] -- in some systems and the fact that other benchmark rates, for other cable systems, will be confiscatorily low. It is in the nature of averages that this will be the case. Thus, even if the basic theory and model of the benchmark rates is sound, some number of systems will require recourse to cost-of-service ratemaking in order to protect themselves against the consequences of benchmark rates that do not cover costs.

Media General is not pleased with the prospect of being obliged to defend its above-benchmark rates through what will likely prove to be a costly process of cost-of-service litigation; however, it recognizes the congressionally directed inevitability of some rate regulation and much prefers the penalty of cost-of-service litigation to the regulatory confiscation of its very considerable investment in the Fairfax County cable system.

For this scheme to work with something approximating fairness to those cable operators whose costs for providing cable services are well above average, it is imperative that they have free access to the process to demonstrate that their above-average costs justify the resulting above-benchmark rates. The suggestions by some commenting parties that

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3/ This is almost certainly true even given the highly questionable assumption that competitive rates for systems not facing effective competition should be 10 percent below the rates averaged to create the benchmarks.

barriers should be erected to a cost-of-service rate defense is constitutionally suspect[4/] and tellingly impractical.

The recitals of one of the commenters urging the Commission to impose a threshold proof of some sort as a condition to eligibility for participation in the cost-of-service procedures outline the possible elements of such an approach:

> Such a threshold showing should include several elements. An operator seeking to justify rates higher than the benchmark should be required to show that these higher rates are necessitated by extraordinarily high and justifiable costs. In order to test whether such high costs are justified, the costs in question should be compared with costs found in other similarly-situated systems. In addition, the recoverable costs must be for expenses that benefit all subscribers; cable subscribers should not be forced to "cross-subsidize" non-cable services or services that only a small number of subscribers may enjoy.

Comments of the National Association of Telecommunications Officers and Advisors, et al., 8 (the "NATOA Comments") (footnotes omitted). Of course a cable system must establish that its costs justify the above-benchmark rates that it wishes to validate. It must also establish that the costs are justifiable. And, we agree that the costs advanced to justify regulated service rates must be associated with regulated services (though we believe that whether all, or only a small number of subscribers, elect to take regulated services should not be relevant).

4/ See, e.g., Comments of Cable Operators and Associations, 9-14; Comments of the California Cable Television Association ("CCTA Comments"), 9-17.

All of which is to say no more than that a cable system invoking the cost-of-service procedures to justify its rates must prove its case. As a general matter, proving one's case is not properly thought of as a threshold matter, and if NATOA means no more than that the cable system must prove its case to prevail, we have no argument with that position. But, given the context of the passage set out above, it seems clear that NATOA really does intend that there be some difference between the threshold showing that it contemplates and the ultimate proof necessary to prevail in a proceeding. Just what that "something different" might consist of is nowhere made clear and is certainly not intuitively obvious.

There are elements of the NATOA formulation that the Commission should decisively reject. Any requirement to prove "... extraordinarily high ... costs ..." is both analytically flawed and terribly naive. Argument by adjective is not normally a highly productive enterprise. What the cable system invoking the cost-of-service proceedings must prove is that its costs justify the above-benchmark rates that it is seeking to defend. To say that such costs are "extraordinarily high" is an exercise in rhetoric that accomplishes nothing. If the NATOA Comments really mean that a cable system invoking the cost-of-service process needs to establish more than that its costs justify the rates proposed, it ignores the purpose of the "safety net" function entrusted to cost-of-service proceedings by the Commission. If NATOA means to assert that it is legally permissible to hold systems to benchmark rates until they

establish that their proper rate should be some established minimum multiple (say, one and one-half times) of benchmark rates, the position is wrong as a matter of constitutional law. See, n.3 above.

The notion of comparing the costs of a cost-of-service petitioner with those of "... other similarly-situated systems..." is not intrinsically offensive. The Commission must, however, recognize the practical limits of such comparisons. Some systems will have cost elements as to which there is no similarly-situated system. In all events, it is unfair to impose on the cable system that seeks cost-of-service treatment the obligation to ferret out information about other systems in order to prove such comparability. A requirement of the kind suggested by NATOA would only further burden the cost-of-service litigation process.

The naivete of NATOA's position is in the assertion, preceding the passage set out above, that absent some threshold hurdle for cost-of-service showings "the Commission and franchising authorities across the nation [will] be inundated with hundreds or thousands of showings, and such showings could become the 'norm' rather than the exception." NATOA Comments at 8. This neglects the fact that cost-of-service proceedings are no more attractive to cable systems than they are to the Commission or franchising authorities. To all concerned, these proceedings will be costly, time-consuming and anything but a pleasure to be lightly pursued. Cable systems will make a reasoned business judgment as to whether the direct economic

costs and collateral business dislocations of cost-of-service litigation are warranted by the need for above-benchmark rates and the likelihood of prevailing in the quest for such rates. Obviously, this latter judgment will become more refined as the Commission and, as appropriate, local franchising authorities, gain experience in actually adjudicating cost-of-service proceedings. The one thing that is certain in all of this is that cable systems will not frivolously litigate cost-of-service proceedings; they will do so only when it is their informed judgment that above-benchmark rates are justified. As adjudicative histories proliferate and the power to predict cost-of-service proceeding outcomes improves, the self-regulation of business judgment should completely supplant any argument in favor of threshold barriers to cost-of-service litigation eligibility.

II. Cost-of-Service Justifications of Rates Above Current Levels Must be Permitted

The Commission requested comment on what is in some ways a more modest "threshold" limitation that is equally unlawful and unreasonable:

> Under this approach, absent a special showing, we would not entertain cost-of-service applications to justify initial regulated rates higher than the systems' existing rates. This approach would be based on the presumption that most operators have set rates in an unregulated environment at a level to be fully compensatory.

Notice at ¶ 18. None of the commenting parties offered a persuasive elaboration of the variety of "special showing" that

would permit cost-of-service rates above existing rates.[5/] It is the Commission's "... presumption that most operators have set rates ... at a level to be fully compensatory ...". This is the source of the dangerously false conclusions that the Commission has reached here.

As we explained in Media General's initial comments in this proceeding,[6/] the presumption advanced by the Commission has no rational basis.[7/] The Comments of the California Cable

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5/ For example, the Staff Comments of the [New Jersey] Board of Regulatory Commissioners propose that the cost-of-service justification for rates above current rates should be permitted only if the system can establish that a "total system rebuild", id. at 4, it has occurred since the current rate levels were established. As we explain in the text above, this is an unacceptable standard because it proceeds from the unjustifiable premise that current rates cover current costs, absent some dramatic change in the cost side of the equation.

6/ See, Comments of Media General Cable of Fairfax County, Inc., MM Docket No. 93-215 (Aug. 25, 1993), 2-4.

7/ The variety of conclusive, or nearly so, presumption advanced by the FCC "... must ultimately be analyzed as calling into question not the adequacy of procedures but -- like our cases involving classifications framed in other terms... -- the adequacy of the 'fit' between the classification and the policy that the classification serves" Michael H. v. Gerald D., 491 U.S. 110, 121 (1989) (citations omitted). Here, the "social policy" at issue is of very significantly less dignity than the issues concerning familial rights as to which the Supreme Court permitted the State of California to make conclusive presumptions in the case cited above. The only interest apparent to us here is the interest in avoiding the costs of what proves to be unsuccessful adjudication; there surely can be no substantive governmental interest in denying cable systems cost-of-service price increases to which they are otherwise entitled. Thus, the "fit" between the systems denied a right to prove their cost of service and the governmental interest in avoiding unproductive litigation is only as good as the empirical basis for the presumption itself. As we demonstrate above, the presumption fits poorly with the facts.

Television Association ("CCTA Comments"), invoking a study done for that Association by an economic consulting firm, establish more generally what Media General asserted to be true of its own circumstances:

> Prior to the rate reregulation of cable, the prices that almost all cable companies charged were unregulated from 1986. However, the unregulated market prices were not in general equal to the COS prices. The industry was pricing its services based on a large number of factors. Economic theory states that a firm prices its services to maximize its long-term profit. Also, this pricing is driven by economic considerations, not by accounting-based COS considerations. Therefore, prices are a function of the firm's economic cost structure, and prices reflect the marginal costs associated with serving customers and the customers' price elasticity. In addition, for a subscription business such as cable television, as the subscriber will provide a stream of revenues in the future, it is economically rational for a cable company to price its services to attract subscribers who will provide a long-term revenue stream.

CCTA Comments at 3. Like any rational business person, a cable operator will occasionally be obliged to price services below cost, but at a level that maximizes revenue and, therefore, minimizes losses. The CCTA Comments provide empirical, as well as analytical, demonstration of this point:

> Empirical evidence suggests that cable system economics, coupled with the discretionary nature of cable service, may not permit systems to follow a COS price path. Using system financial and operating data provided by California cable companies, CCTA's consulting economists, Barakat & Chamberlin, developed preliminary pro forma COS rates based on the Commission's proposed COS standards, excluding acquisition intangibles. In seven of ten systems, COS rates were higher (up to 200% to 340% higher) than existing rates. Likewise, COS rates were as much as 200% higher than benchmark rates in six systems.

Id. at 4. Plainly, if a cable system is able to demonstrate that its costs of service justify rates above current levels, those rates are permissible. No "presumption" concerning past behavior can overwhelm the proven facts.

III. Cable Operators Should be Permitted to Justify Rates for Each Tier of Service on Either Benchmark or Cost-of-Service Grounds

The Commission, in a companion proceeding,[8/] has proposed an analytically different, but no more acceptable, limitation on access to cost-of-service relief from confiscatory rates. The proposal is that "... cable operators should be required to elect either the benchmark or the cost-of-service approach for all regulated tiers." Rate Reconsideration at ¶ 48. The rationale for this kind of conclusion was to protect "... tier neutrality and also [eliminate] any incentive to 'game' the regulatory process." Id. at ¶ 149. The Commission expressly recognized that "the Rate Order did not explicitly state whether [a] cable operator is permitted to choose the cost-of-service approach for one tier and [the] benchmark approach for the other tier...." Id. at ¶ 146. Media General read 47 C.F.R. § 76.922(b), as the Commission properly suggested that a rational reader might, as permitting "... cable operators to elect one showing on one tier and another showing on another tier." Id. The rates that were published

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8/ First Order on Reconsideration, Second Report and Order, and Third Notice of Proposed Rulemaking, MM Docket No. 92-266 (FCC 93-428, released August 27, 1993) ("Rate Reconsideration").

for Media General on August 31, 1993, were based on precisely this approach, assuming benchmark rates for the basic tier of service and cost-of-service justified rates for the second tier of service. The freedom to set rates in this fashion ought not to be limited. None of the rationales for a contrary conclusion advanced in the Rate Reconsideration order is persuasive.

The notion of "gaming" the regulatory process can be protected against by more limited regulatory constraints. As we understand it, the harm to be avoided is the possibility that systems will achieve supra-competitive profits in a benchmark-priced basic tier of service by limiting the offerings on that tier to a small number of the least expensive programming choices available on the system.[9/] There is a simple safeguard against this occurrence. If the cost-of-service showing for a system seeking to justify upper tier rates also establishes that the benchmark rate of the basic tier is at or below the cost of service for that tier, the Commission's fears will be allayed. In order to be clear that the cost-of-service demonstration for the upper tier has properly attributed joint and common costs, the Commission will

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9/ Because benchmark per-channel rates are established as an average of revenues per subscriber per channel on all regulated channels of the sampled systems used by the Commission to establish these rates, the result feared is analytically possible. Precisely because the services on upper tiers are generally more costly to provide than the average cost of basic tier services, a system could have basic tier costs significantly below the benchmark rates.

be obliged to examine the proportion of total system costs assigned to the basic tier of service. Because this proof will be an inevitable part of the second tier cost-of-service justification, there will be no additional burden on the adjudicative process to establish that the benchmark-based basic tier rates are at or below the cost of service to that tier.

Nor will the approach that we advocate violate the precepts of "tier neutrality" in any important way. Indeed, the "all or nothing" approach to cost-of-service justification tentatively endorsed by the Commission is likely to do more damage to the Commission's hopes for a healthy complement of basic service offerings at an easily affordable price.

One must begin analysis with the recognition that, at least in the context of a cost-of-service proceeding,[10/] there are provable total system costs of providing cable service. And, as we have established, a cable operator has a fundamental economic and constitutional right to recover those costs. The issue, for cable systems such as Media General that have more than one tier of regulated service, is how those costs should be divided among subscribers who choose different service offerings. In Media General's case, the costs of providing

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10/ The analysis that guided the Commission's determinations concerning benchmark rates was based on prices, not costs. Thus, cost-of-service proceedings which, by definition, disclose information additional to that which was available in the Commission's benchmark analysis must proceed from a fundamentally different perspective.

second tier programming[11/] are higher than the comparable programming costs for the basic tier. The notion of "tier neutrality" endorsed by the Commission in its benchmark procedures -- an equal price per channel without regard to variations in cost per channel -- would have the perverse effect in circumstances such as those faced by Media General of obliging those subscribers who take only basic tier service to subsidize the higher cost services offered to those who subscribe to the second tier as well. That outcome is obviously unfair to basic service subscribers and it irrationally curtails the exercise of business judgment by cable system operators. It also would be contrary to Congressional and franchise authority intent to facilitate access to cable services by lower-income citizens. If operators wish to minimize the cost of basic tier service, recovering the high cost of services provided on the second tier from those who choose to subscribe to it, the Commission should not stand in the way of this business judgment. The outcome cannot be said to injure either basic-only subscribers, who are assured by the process that we have described of not paying more than the cost to the system of providing basic service or those subscribers who value the benefits of also subscribing to the second tier sufficiently to pay the greater

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11/ We have no objection to allocating costs common to all tiers of service, such as embedded plant, on a tier-neutral basis. Costs that are caused in equal measure by every channel of regulated service ought to be borne in equal measure by each channel of regulated service.

cost associated with that service. If the Commission genuinely wants for its regime of rate regulation to mimic the effects of a competitive economy, the possibility of this outcome is imperative, for it is the one that the market would dictate.

IV. Additional Procedural Considerations

The advent of rate regulation will not overcome certain market realities. It is likely to be the case, for example, that, for at least some cable systems, it will not be rational[12/] to set rates at a level that fully recovers costs. For such systems, the Commission should permit the system to establish its costs of service and insulate the system from further rate challenges until such time as the rates actually charged exceed the costs adjudicated.

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12/ This is true for the reasons that we address at pages 7-8 above.